

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 4
[Docket No. 97-02]
RIN 1557-AB56

FEDERAL RESERVE SYSTEM
12 CFR Part 208
[Regulation H; Docket No. R-0957]

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 337
RIN 3064-AB90

DEPARTMENT OF THE TREASURY
Office of Thrift Supervision
12 CFR Part 563
[Docket No. 96-114]
RIN 1550-AB02

Expanded Examination Cycle For Certain
Small Insured Institutions

AGENCIES: Board of Governors of the Federal Reserve System,
Office of the Comptroller of the Currency, Federal Deposit
Insurance Corporation, and Office of Thrift Supervision.

ACTION: Interim rule with request for comment.

SUMMARY: The Board of Governors of the Federal Reserve System (Board), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) (collectively, the Agencies) are issuing this joint interim rule with request for comment to implement section 306 of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI), and section 2221 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). CDRI section 306 and EGRPRA section 2221 authorize the Agencies to increase the asset size of certain financial institutions that

may be examined once in every 18-month period, rather than once in every 12-month period, from the current limit of \$100 million to a revised limit of \$250 million. This interim rule makes certain institutions that have \$250 million or less in assets eligible for the 18-month examination schedule.

Furthermore, section 2214 of EGRPRA amends the International Banking Act of 1978 and requires that each Federal branch or agency, and each State branch or agency, of a foreign bank be subject to on-site examination by an appropriate Federal banking agency or State banking supervisor as frequently as would a national or a state bank, respectively, by the appropriate Federal banking agency. Certain issues are raised regarding the manner in which the criteria established by CDRI and EGRPRA for a national or state bank should be made applicable to U.S. branches and agencies of foreign banking organizations. The method(s) by which the criteria will be applied to such entities is currently being developed.

DATES: This interim rule is effective on February 12, 1997. Comments must be received by April 14, 1997.

ADDRESSES: Comments should be directed to:

OCC: Communications Division, Office of the Comptroller of the Currency, 250 E Street S.W., Washington, D.C. 20219, Attention: Docket No. 97-02. Comments will be available for public inspection and photocopying at the same location. Comments may also be sent by facsimile transmission to (202)874-5274 or by electronic mail to Regs.comments@occ.treas.gov.

Board: William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551, and refer to Docket No. R-0957. Comments addressed to Mr. Wiles may also be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m., and to the security control room outside of those hours. Both the mail room and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, N.W. Comments may be inspected in room MP-500 between 9:00a.m. and 5:00p.m., except as provided in Section 261.8 of the Board's Rules Regarding the Availability of Information, 12 CFR 261.8.

FDIC: Jerry L. Langley, Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429. Comments may be hand delivered to room F-402, 1776 F Street, N.W., Washington, D.C. on business days between 8:30 a.m. and 5:00 p.m. Comments may be sent through facsimile to (202) 898-3838 or by Internet to comments@fdic.gov. Comments will be available for inspection at the FDIC Public Information Center, Room 100, 801 17th Street, N.W., Washington, D.C. on business days between 9:00 a.m. and 4:30 p.m.

OTS: Manager, Dissemination Branch, Records Management and Information Policy, Office of Thrift Supervision, 1700 G Street, N.W., Washington, D.C. 20552, Attention Docket No. 96-114. These submissions may be hand-delivered to 1700 G Street, N.W., from 9:00 a.m. to 5:00 p.m. on business days; they may be sent by facsimile transmission to FAX Number (202) 906-7755. Comments

will be available for inspection at 1700 G Street, N.W., from 9:00 a.m. until 4:00 p.m. on business days.

FOR FURTHER INFORMATION CONTACT:

OCC: Lawrence W. Morris, National Bank Examiner, Examination Process (202) 874-4915; Ronald Schneck, Director, Special Supervision, (202) 874-4450; or Mark Tenhundfeld, Assistant Director, Legislative and Regulatory Activities, (202) 874-5090; Timothy M. Sullivan, Director, International Banking and Finance, (202) 874-4730.

Board: Jack P. Jennings, II, Assistant Director, (202) 452-3053, William H. Tiernay, Senior Financial Analyst, (202) 872-7579, Betsy Cross, Manager, Division of Banking Supervision and Regulation, or Greg Baer, Managing Senior Counsel, (202) 452-3236, Legal Division.

FDIC: Mark A. Mellon, Counsel, Regulation and Legislation section (202) 898-3854, Legal Division, or Robert W. Walsh, Manager, Planning and Program Development section (202) 898-6911, Division of Supervision, or international contact: Karen M. Walter, Review Examiner (202) 898-3540, Division of Supervision, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

OTS: Scott M. Albinson, Special Assistant to the Executive Director, Supervision, (202) 906-7984; or Ellen J. Sazzman, Counsel (Banking and Finance), Regulations and Legislation Division, Office of the Chief Counsel, (202) 906-7133.

SUPPLEMENTARY INFORMATION:

Background

Section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. 102-242, 105 Stat. 2236 (1991)(12 U.S.C. 1820(d)), established a requirement that each appropriate Federal banking agency conduct a full-scope on-site examination of each insured depository institution that it supervises at least once during each 12-month period.¹ It allowed an exception, however, for certain small insured depository institutions that are well managed and well capitalized, permitting such institutions to be examined once during each 18-month period. To qualify, an institution was required to have \$100 million or less in total assets and its composite condition must have been found to be outstanding (rated 1 under the Uniform Financial Institutions Rating System (UFIRS)) at its most recent examination. In addition, qualifying institutions must not have experienced a change in control during the previous 12-month period in which a full scope examination would have been required by 12 U.S.C. 1820(d).

In 1994, Congress amended this provision to expand the availability of an 18-month examination cycle to a broader number of small institutions. CDRI section 306, Pub. L. 103-325, 108 Stat. 2160 (1994), amended section 10(d)(4) of the FDI Act to increase to \$250 million the total-asset size of institutions

¹Section 111 amended section 10 of the Federal Deposit Insurance Act (the FDI Act) by adding a new subsection (d), codified at 12 U.S.C. 1820(d).

rated outstanding (UFIRS 1) that could be examined on an 18-month cycle. CDRI section 306 also added a provision permitting an 18-month cycle for institutions rated satisfactory (UFIRS 2) at their most recent examination, provided they did not exceed \$100 million in total assets. CDRI also authorized the Agencies to increase that \$100 million threshold to \$175 million beginning on September 23, 1996. CDRI further requires that to qualify for the expanded examination cycle, the insured institutions not be subject to a formal enforcement proceeding or order, and that they meet all the other criteria of section 10(d) of the FDI Act, which were not changed by CDRI. These criteria require that an institution: (1) be well capitalized; (2) be well managed; and (3) must not have experienced a change in control during the previous 12-month period.

EGRPRA section 2221 provides that, at any time after September 23, 1996, the Agencies, in their discretion, may increase to \$250 million the maximum asset size of UFIRS 2-rated institutions eligible for examination on an 18-month cycle. CDRI requires that the Agencies implement this provision by regulation and that they first determine that the increased amount is consistent with the principles of safety and soundness for insured depository institutions. (12 U.S.C. 1820(d)(10)).

The International Banking Act of 1978 (the IBA), as amended by the Foreign Bank Supervision Enhancement Act of 1991, requires an examination of each U.S. branch or agency of a foreign bank once during each 12-month period. 12 U.S.C. 3105(c)(1)(C).

EGRPRA section 2214 amended the IBA to provide that each Federal or State branch or agency of a foreign bank shall be subject to on-site examination by an appropriate Federal or State banking agency as frequently as would a national or state bank, respectively, by the appropriate Federal banking agency. Consequently, U.S. branches or agencies of foreign banks are eligible for the 18-month cycle provided that they meet the qualifying criteria outlined above. The method by which these qualifying criteria should be applied to Federal and State branches and agencies is currently under consideration. The Board, the OCC and the FDIC request comment regarding application of these criteria to U.S. branches and agencies of foreign banks.

The Agencies have determined that increasing the size limitation of UFIRS 2-rated institutions that are eligible for an 18-month cycle is generally consistent with the safety and soundness of insured depository institutions assuming the absence of other risk factors. A longer examination cycle permits the Agencies to focus their resources on the segments of the banking and thrift industry that present the most immediate supervisory concern, while concomitantly reducing the regulatory burden on smaller, well-run institutions that do not pose an equivalent level of supervisory concerns. In lieu of the more frequent examinations that would otherwise be conducted for these institutions once in every 12-month period, the Agencies rely upon off-site monitoring tools to identify potential problems in smaller, well-managed institutions that present low levels of

risk. Moreover, neither the statute nor the regulation limits, and the Agencies therefore retain, the authority to examine an insured depository institution more frequently. The Agencies that supervise state-chartered insured institutions also recognize that flexibility must be made available in the implementation of this regulation to accommodate requirements for annual examinations by various states.

Description of the Interim Rule

This interim rule makes eligible for an 18-month examination schedule an institution that: (1) has total assets of \$250 million or less; (2) is well capitalized; (3) is well managed; (4) received a UFIRS rating of 1 or 2 at its most recent examination; (5) is not subject to a formal enforcement proceeding or order; and (6) has not experienced a change in control during the previous 12-month period. This interim rule increases the number of institutions eligible for an 18-month examination cycle by about 1,087 institutions (300 national banks, 497 nonmember banks, 105 state member banks, and 185 savings associations), thereby reducing the regulatory burdens attendant to the examination process for those institutions and freeing additional supervisory resources to focus on higher-risk institutions. Off-site monitoring and the discretionary ability to examine institutions more frequently minimizes the supervisory risks of the less-frequent examinations. Furthermore, the supervisory emphasis that the Agencies are placing on risk management assessment provides reasonable assurance that a "well

managed" institution has been evaluated on its ability to identify and monitor risk, and to deal effectively with changes in its environment that may occur between examinations.

The Agencies find good cause for issuing this interim rule without prior notice and the opportunity for comment and for dispensing with the 30-day delayed effective date ordinarily prescribed by the Administrative Procedure Act, 5 U.S.C. 551 et seq. (the APA). This interim rule confers a benefit on certain small insured depository institutions by reducing the frequency of, and therefore the regulatory burden associated with, on-site examinations. Making the 18-month examination cycle effective immediately will maximize the benefit of this burden reduction by enabling the Agencies to incorporate immediately the revised examination schedule into their planning for 1997. Conversely, this interim rule does not increase the frequency of examination or otherwise increase the regulatory burden for any insured depository institution. Thus, those institutions that are not eligible for the exemption from the statutorily prescribed 12-month examination cycle are not adversely affected by the interim rule. Under these circumstances, the Agencies conclude that prior notice and comment procedures are unnecessary and would be contrary to the public interest. 5 U.S.C. 553(b)(B).

In addition, the Agencies have determined that, under the APA, examination schedules are a matter of internal agency procedure. See *Donovan v. Wollaston Alloys, Inc.*, 695 F.2d 1, 9 (1st Cir. 1982). Determining when an insured financial

institution is to be examined is based, in part, on examiner availability, the Agencies' need to plan examiner time in advance, and other issues relevant to the internal operations of the Agencies. This interim rule is a matter of internal agency procedure rather than a rule of substantive effect on bank activities and authority. Therefore, this interim rule is exempt from the APA's public notice requirement. 5 U.S.C. 553(b)(3)(A).

The Agencies are nonetheless interested in the views of the public and are therefore requesting comment on this interim rule, as well as how the qualifying criteria should be applied to the U.S. branches and agencies of foreign banks. An interim rule for each agency is set out below.

REGULATORY FLEXIBILITY ACT

An initial regulatory flexibility analysis under the Regulatory Flexibility Act (the RFA) is only required whenever an agency is required to publish a general notice of proposed rulemaking for any proposed rule. 5 U.S.C. 603. As noted previously, the Agencies have determined that is not necessary to publish a notice of proposed rulemaking for this rule. Accordingly, an initial regulatory flexibility analysis is not required.

PAPERWORK REDUCTION ACT

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506), the Agencies have determined that no collections of information pursuant to the Paperwork Reduction Act are contained in this interim rule.

OCC and OTS EXECUTIVE ORDER 12866 STATEMENT

The OCC and OTS have each independently determined that this interim rule with request for comment is not a significant regulatory action under Executive Order 12866.

OCC and OTS UNFUNDED MANDATES ACT of 1995 STATEMENT

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4, 109 Stat. 48 (March 22, 1995) (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. Because the OCC and OTS have each independently determined that this interim rule will not result in expenditures by state, local, and tribal governments, in the aggregate, or by the private sector, of more than \$100 million in any one year, the OCC and OTS have not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered. Nevertheless, as discussed in the preamble, this interim rule will have the effect of reducing regulatory burden on certain institutions.

List of Subjects

12 CFR Part 4

Freedom of information, Organization and functions
(Government agencies), Reporting and recordkeeping requirements.

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential
business information, Crime, Currency, Federal Reserve System,
Flood insurance, Mortgages, Reporting and recordkeeping
requirements, Safety and soundness, Securities.

12 CFR Part 337

Banks, banking, Reporting and recordkeeping requirements,
Securities.

12 CFR Part 563

Accounting, Advertising, Crime, Currency, Investments,
Reporting and recordkeeping requirements, Savings associations,
Securities, Surety bonds.

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons set forth in the joint preamble, part 4 of
chapter I of title 12 of the Code of Federal Regulations is
amended as follows:

**PART 4--ORGANIZATION AND FUNCTIONS, AVAILABILITY AND RELEASE OF
INFORMATION, CONTRACTING OUTREACH PROGRAM**

1. The authority citation for part 4 is revised to read as
follows:

AUTHORITY: 12 U.S.C. 93a. Subpart A also issued under

5 U.S.C. 552; 12 U.S.C. 481, 1820(d). Subpart B also issued under 5 U.S.C. 552; E.O. 12600 (3 CFR, 1987 Comp., p. 235). Subpart C also issued under 5 U.S.C. 301, 552; 12 U.S.C. 481, 482, 1821(o), 1821(t); 18 U.S.C. 641, 1905, 1906; 31 U.S.C. 9701. Subpart D also issued under 12 U.S.C. 1833e.

2. In Subpart A, a new § 4.6 is added to read as follows:

§ 4.6 Frequency of examination

(a) General. The OCC examines national banks pursuant to authority conferred by 12 U.S.C. 481 and the requirements of 12 U.S.C. 1820(d). The OCC is required to conduct a full-scope, on-site examination of every national bank at least once during each 12-month period.

(b) 18-month rule for certain small institutions. The OCC may conduct a full-scope, on-site examination at least once during each 18-month period, rather than each 12-month period as provided in paragraph (a) of this section, if the following conditions are satisfied:

(1) The national bank has total assets of \$250 million or less;

(2) The national bank is well capitalized as defined in 12 CFR part 6;

(3) At its most recent examination, the OCC found the national bank to be well managed;

(4) At its most recent examination, the OCC determined that the national bank was in outstanding or good condition, that is,

it received a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (Copies are available at the addresses specified in § 4.14 of this chapter);

(5) The national bank currently is not subject to a formal enforcement proceeding or order by the FDIC, OCC, or Federal Reserve Board; and

(6) No person acquired control of the national bank during the preceding 12-month period in which a full-scope on-site examination would have been required but for this section.

(c) Authority to conduct more frequent examinations. This section does not limit the authority of the OCC to examine any national bank as frequently as the agency deems necessary.

December 23, 1996

Date

Eugene A. Ludwig

Comptroller of the Currency

Federal Reserve System

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the joint preamble, the Board amends part 208 of chapter II of title 12 of the Code of Federal Regulations as follows:

PART 208--MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

1. The authority citation for part 208 is revised to read as follows:

Authority: 12 U.S.C. 36, 248(a), 248(c), 321-338a, 371d, 461, 481-486, 601, 611, 1814, 1820(d)(8), 1823(j), 1828(o), 1831o, 1831p-1, 3105, 3310, 3331-3351, and 3906-3909; 15 U.S.C. 78b, 781(b), 781(g), 781(i), 78o-4(c)(5), 78q, 78q-1 and 78w; 31 U.S.C. 5318; 42 U.S.C. 4012a, 4104a, 4104b, 4106 and 4128.

2. In Subpart A, a new § 208.26 is added to read as follows:

§ 208.26 Frequency of examination.

(a) General. The Federal Reserve examines insured member banks pursuant to authority conferred by 12 U.S.C. 325 and the requirements of 12 U.S.C. 1820(d). The Federal Reserve is required to conduct a full-scope, on-site examination of every insured member bank at least once during each 12-month period.

(b) 18-month rule for certain small institutions. The Federal Reserve may conduct a full-scope, on-site examination at least once during each 18-month period, rather than each 12-month

period as provided in paragraph (a) of this section, if the following conditions are satisfied:

(1) The insured member bank has total assets of \$250 million or less;

(2) The insured member bank is well capitalized as defined in subpart B of this part (§ 208.33);

(3) At its most recent examination, the Federal Reserve found the insured member bank to be well managed;

(4) At its most recent examination, the Federal Reserve determined that the insured member bank was in outstanding or good condition, that is, it received a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (Copies are available at the address specified in § 216.6 of this chapter);

(5) The insured member bank currently is not subject to a formal enforcement proceeding or order by the FDIC, OCC, or Federal Reserve Board; and

(6) No person acquired control of the insured member bank during the preceding 12-month period in which a full-scope on-site examination would have been required but for this section.

(c) Authority to conduct more frequent examinations. This section does not limit the authority of the Federal Reserve to examine any insured member bank as frequently as the agency deems necessary.

By order of the Board of Governors of the Federal Reserve
System, January 23, 1997.

William W. Wiles
Secretary of the Board.

Federal Deposit Insurance Corporation**12 CFR Chapter III****Authority and Issuance**

For the reasons set forth in the joint preamble, the Board of Directors of the FDIC amends part 337 of chapter III of title 12 of the Code of Federal Regulations to read as follows:

PART 337 -- UNSAFE AND UNSOUND BANKING PRACTICES

1. The authority citation for part 337 is revised to read as follows:

Authority: 12 U.S.C. 375a(4), 375b, 1816, 1818(a), 1818(b), 1819, 1820(d)(10), 1821(f), 1828(j)(2), 1831f, 1831f-1.

2. A new § 337.12 is added to read as follows:

§ 337.12 Frequency of examination

(a) General. The Federal Deposit Insurance Corporation examines insured state nonmember banks pursuant to authority conferred by section 10 of the Federal Deposit Insurance Act (12 U.S.C. 1820). The FDIC is required to conduct a full-scope, on-site examination of every insured state nonmember bank at least once during each 12-month period.

(b) 18-month rule for certain small institutions. The FDIC may conduct a full-scope, on-site examination at least once during each 18-month period, rather than each 12-month period as provided in paragraph (a) of this section, if the following conditions are satisfied:

(1) The insured state nonmember bank has total assets of \$250 million or less;

(2) The insured state nonmember bank is well capitalized as defined in 12 CFR 325.103(b)(1);

(3) At its most recent examination, the FDIC found the insured state nonmember bank to be well managed;

(4) At its most recent examination, the FDIC determined that the insured state nonmember bank was in outstanding or good condition, that is, it received a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (Copies are available at the addresses specified in § 309.4 of this chapter);

(5) The insured state nonmember bank currently is not subject to a formal enforcement proceeding or order by the FDIC, OCC, or Federal Reserve Board; and

(6) No person acquired control of the insured state nonmember bank during the preceding 12-month period in which a full-scope on-site examination would have been required but for this section.

(c) Authority to conduct more frequent examinations. This section does not limit the authority of the FDIC to examine any insured state nonmember bank as frequently as the agency deems necessary.

By order of the Board of Directors.

Dated at Washington, DC, this 21st day of January, 1997.

FEDERAL DEPOSIT INSURANCE CORPORATION

Jerry L. Langley

Executive Secretary

(SEAL)

Office of Thrift Supervision**12 CFR Chapter V****Authority and Issuance**

For the reasons set forth in the joint preamble, the OTS amends part 563 of Chapter V of title 12 of the Code of Federal Regulations as follows:

PART 563 - OPERATIONS

1. The authority citation for part 563 is revised to read as follows:

Authority: 12 U.S.C. 375b, 1462, 1462a, 1463, 1464, 1467a, 1468, 1817, 1820, 1828, 3806; 42 U.S.C. 4106.

2. § 563.171 is added to read as follows:

§ 563.171 Frequency of examination.

(a) General. The OTS examines savings associations pursuant to authority conferred by 12 U.S.C. 1463 and the requirements of 12 U.S.C. 1820(d). The OTS is required to conduct a full-scope, on-site examination of every savings association at least once during each 12-month period.

(b) 18-month rule for certain small institutions. The OTS may conduct a full-scope, on-site examination at least once during each 18-month period, rather than each 12-month period as provided in paragraph (a) of this section, if the following conditions are satisfied:

(1) The savings association has total assets of \$250 million or less;

(2) The savings association is well capitalized as defined

in 12 CFR 565.4;

(3) At its most recent examination, the OTS found the savings association to be well managed;

(4) At its most recent examination, the OTS determined that the savings association was in outstanding or good condition, that is, it received a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (Copies are available at the addresses specified in § 516.1 of this chapter);

(5) The savings association currently is not subject to a formal enforcement proceeding or order; and

(6) No person acquired control of the savings association during the preceding 12-month period in which a full-scope on-site examination would have been required but for this section.

(c) Authority to conduct more frequent examinations. This section does not limit the authority of the OTS to examine any savings association as frequently as the agency deems necessary.

Dated: November 20, 1996
By the Office of Thrift Supervision

Nicolas P. Retsinas
Director